

ADVANCING SUKUK MARKETS : Legal Frameworks, Regulatory Developments, and Default Challenges in Malaysia and the United Arab Emirates

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Article Info	Abstract
<p>Article history: Received May 09, 2025 Revised May 27, 2025 Accepted April 29, 2025</p> <hr/> <p>*Corresponding author email: abdullah2016ziarmal@gmail.com</p> <hr/> <p>Keywords: Sukuk, Islamic Capital Market, Legal Framework, Regulatory Challenges</p>	<p>Introduction: This study examines recent developments and key challenges in the sukuk markets of Malaysia and the United Arab Emirates (UAE), with a focus on legal, regulatory, and post-default frameworks. It analyzes the institutional structures that shape sukuk issuance in both countries. Research Methods: Using a qualitative approach, the research draws on academic literature, official reports, news articles, and other relevant sources. It also outlines fundamental sukuk theories, instruments, and global market issues. Results: The findings indicate that both countries have made notable progress in advancing socially responsible sukuk and regulatory initiatives. However, the UAE faces challenges such as the absence of standardized legal frameworks and independent rating agencies. Malaysia, while leading globally in sukuk issuance, continues to encounter difficulties aligning its regulations with international standards. Conclusion: The study recommends greater standardization, increased sukuk issuance, and more transparent post-default mechanisms to support the long-term development of sukuk markets.</p>
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INTRODUCTION

Since 20 years, several financial regulators and investment institutions around the world have been dedicated to strengthening feasibility in Islamic capital markets, and influence standards for Sukuk as a key investment asset class (Zolfaghari P., 2017). This is a fact that since last two decades accelerated growth in the products of the Islamic finance industry, including Islamic banking, takaafu (Islamic insurance) and the Islamic capital market has been witnessed. a significant upward slope in the issuance of sukuk (Islamic investment certificates) across the globe, prevailing in Muslim-majority countries (Khan et al., 2020). according to (Abrorov, 2020), In last years, Islamic finance has shown a positive tendency. Islam financial assets reached to USD 2.4 trillion in 2017 (Islamic & Insights, n.d.). According to the calculations, by the end of 2024, it will be reached up to USD 3.4 trillion (Nazar, n.d.). Second largest sector of Islamic finance – sukuk is growing rapidly. After the end of 2018, emissions for the all period amounted to 1.1 trillion US dollars, including in 2018 - 123.15 billion US dollars (IIFM, 2019).

Attachment with Islamic finance has been brought up after the global financial crisis in 2007-2008. Scientific research has shown that Islamic finance is more stable and resistant to crisis than traditional finance (Kusuma & Silva, 2014). Sukuk provides alternative long-term financing for key sectors such as infrastructure. Infrastructure assets that provide long-term stable cash flows are usually suitable to back sukuk structures. Sukuk (plural of 'sakk' the Arabic word for certificate) are described as certificates representing a proportional and undivided ownership right in tangible asset (Yean, 2009). These assets must be in a specific project or in investment activities that comply with shariah rules and principles. In contrast to conventional bonds which are debt obligation and its holders are receiving periodic fixed interest, sukuk are Islamic financial means representing ownership in tangible assets and its holders are receiving profit generated by the underlying assets on a periodic basis (Miyazaki, 2010).

Lack of standardization, narrow liquidity, and concerns regarding insolvency regimes are basic obstacles among others, for further expansion of the sukuk asset class. Despite the favourable trend, full potential of sukuk markets only be achieved will if these impediments are tackled, along with others related to a broader market development agenda. Significant efforts by the Islamic financial industry and policy makers are under way to develop standards and improve practices that could address such hurdles (Zolfaghari P., 2017).

Since last few years, the global sukuk market had saw solid growth, as annual issuances almost tripled from USD45 billion in 2011 to USD118.8 billion in 2014 (Hosen et al., 2018). According to the (Hosen et al., 2018), This important growth was pushed through both leading markets such as Malaysia, Saudi Arabia, and the United Arab Emirates (UAE), in addition Turkey and Indonesia.

On the other hand, sukuk market has been declined almost 20% in early 2010, which states an unclear intentions of investors regarding investing in sukuk market (Nazar, n.d.). in last few years so many defaults have been registered in sukuk markets in various countries in the

world. To clear it further, Nakheel sukuk alongside Dana gas sukuk defaults are the most controversial one and resulted to pose legal risk in sukuk market. On this occasion, this study seeks in order to analyse and illustrate the recent challenges in sukuk markets of Malaysia, UAE. Mentioned analyses and illustrations is dependent to the answers to following research questions and objectives.

Since 2017, sukuk markets have faced ongoing legal and regulatory challenges, particularly regarding the handling of defaults. These issues often stem from the tension between Islamic law (Shariah), which underpins sukuk structures, and conventional legal systems that may not fully accommodate Shariah principles. This legal incompatibility can result in disputes and undermine investor confidence. A prominent example is the Dana Gas sukuk case in the United Arab Emirates, which highlighted how differing interpretations of Shariah and the lack of legal standardization can create uncertainty in sukuk enforcement.

In response to these concerns, this study aims to examine recent developments and challenges in the sukuk markets of Malaysia and the UAE. The objectives are to (1) identify key legal and regulatory challenges, (2) differentiate between various types of challenges—legal, regulatory, and default-related, and (3) analyze the mechanisms used to address defaults in both jurisdictions. Accordingly, the study is guided by several key questions: What are the legal and regulatory frameworks of sukuk markets in Malaysia and the UAE? What are the major legal challenges facing these markets? What factors contribute to these challenges? In addition, the study investigates how defaults are treated and what types of sukuk are commonly issued in each market.

RESEARCH METHOD

This research employs a qualitative-descriptive approach to analyze and compare the legal, regulatory, and default-related challenges in the sukuk markets of Malaysia and the United Arab Emirates. A qualitative approach is suitable for understanding complex legal frameworks and interpreting textual data from multiple jurisdictions (Creswell, 2014). The study is based entirely on secondary data sources, which include official publications such as annual financial reports, regulatory guidelines, Shariah rulings (fatwas), relevant academic literature, legal documents, and credible news sources (Bowen, 2009).

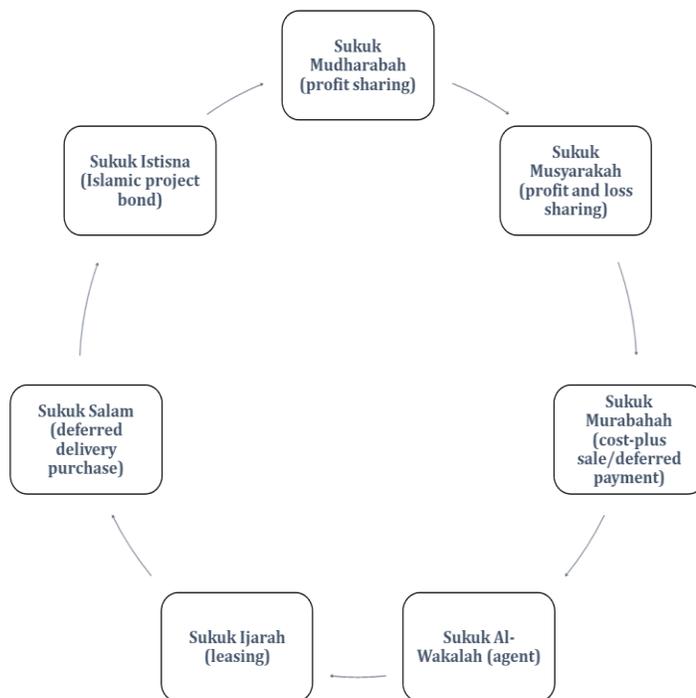
The analysis begins with an overview of the sukuk market in Malaysia, followed by that of the UAE. For each country, the study presents an in-depth discussion on types of sukuk, the existing legal and regulatory systems, as well as the mechanisms in place for managing defaults. The data collected are interpreted using content analysis and comparative legal analysis, aiming to identify the structural differences and highlight the recurring legal and regulatory challenges that impact sukuk market development (Krippendorff, 2018; Kamba, 2010). This method allows the study to explore the interaction between Shariah-compliant financial instruments and the statutory legal systems in each country.

RESULT AND DISCUSSION

Malaysian Sukuk Market

Malaysia is at the lead in the development of Islamic banking, an Islamic capital market, and takaful insurance. It has a strong and comprehensive Islamic financial system with a robust business-driven regulatory regime and legal framework. Malaysia has emerged as the largest sukuk market in the world. The sukuk market has become an integral part of the Malaysian capital market. According to the MIFC, as at end-April 2018, Malaysia accounts for 51.7% of global Sukuk outstanding compared to other jurisdictions such as Saudi Arabia (19.1%), the UAE (8.1%), Indonesia (7.5%), Qatar (4.1%) and others (9.5%). The healthy and sustainable pipeline of Sukuk issuance that the country enjoys, from both the public and private sectors, is backed by a strong value proposition for Sukuk, placing it at a comparative advantage over conventional bonds. Based on the Securities Commission Malaysia's Securities Commission (SC) data, the size of the ICM as a percentage of Malaysia's capital market has already surpassed 60% as at May 2018. Growth of the ICM has been supported by an active corporate Sukuk market as well as regular issuance of sovereign Sukuk to fund GoM expenditure (Deloitte and ISRA, 2018). In term of infrastructure of Malaysian sukuk, In Malaysia, the market infrastructure is the same for sukuk and conventional bonds and notes. Sukuk are traded over-the-counter (OTC) on the same registered electronic facilities as conventional debt securities, or as exchange-traded bonds and sukuk (ETBS) on Bursa Malaysia Securities (BMS).

Figure 1. Types of Sukuk in Malaysian sukuk market



Source: Compiled by the author based on IIFM (2021) and IFSB (2020).

1. Legal framework in Malaysia

The legal infrastructure governing sukuk varies significantly across jurisdictions that engage in Islamic finance. This variation in legal development plays a crucial role in determining the success and growth of sukuk markets globally. Among these jurisdictions, Malaysia stands out as a leading example, possessing one of the most active Islamic capital markets worldwide. The country's legal framework is rooted in English common law, which has been adapted to accommodate Islamic financial principles through comprehensive and well-structured regulatory mechanisms. The primary regulatory authorities—Bank Negara Malaysia (BNM) and the Securities Commission Malaysia (SC)—have established a robust legal and regulatory environment for the issuance and governance of sukuk.

In Malaysia, sukuk are regulated under a series of legislative acts that provide legal certainty and promote investor confidence. According to (Hosen, 2016), these include the *Securities Industry (Central Depository) Act 1991*, the *Securities Industry Act 1983*, the *Futures Industry Act 1993*, and the *Capital Markets and Services (Amendment) Act 2011*. These laws collectively support the issuance, trading, and settlement of sukuk instruments while ensuring alignment with both Shariah principles and global financial standards. This comprehensive legal infrastructure positions Malaysia as a benchmark for sukuk regulation and highlights the importance of a well-developed legal system in supporting Islamic finance markets.

2. Regulatory Framework Governing Sukuk in Malaysia

The Malaysian financial system operates under a comprehensive legal framework designed to ensure that it remains well-regulated, secure, and resilient. A significant legislative reform in this regard was the enactment of the *Central Bank of Malaysia Act 2009 (CBA)*, which superseded the earlier *Central Bank of Malaysia Act 1958*. This Act provides enhanced clarity regarding the mandates of Bank Negara Malaysia (BNM), particularly in promoting both monetary and financial stability. In fulfilling its financial stability mandate, the CBA outlines several core responsibilities of the central bank: regulating and supervising financial institutions within its jurisdiction, overseeing money and foreign exchange markets, supervising payment systems, and developing a sound, progressive, and inclusive financial system.

In the context of Malaysia's sukuk market, several primary legislations serve as the legal backbone for regulatory governance. These include the *Securities Commission Act 1993 (SCA)*, the *Capital Markets and Services Act 2007 (CMSA)*, the *Securities Industry (Central Depositories) Act 1991 (SICDA)*, and the *Companies Act 2016 (CA)*. These laws collectively support the issuance, regulation, and operation of sukuk within a framework that aligns with both Shariah principles and international standards. In addition to these core legislations, the sukuk regulatory landscape is further reinforced by a range of

supplementary instruments such as ministerial orders, directives issued by the Securities Commission Malaysia, and various guidelines that provide detailed operational procedures and compliance requirements. Together, these components establish a robust and transparent legal infrastructure for the development and governance of the sukuk market in Malaysia.

Recent Development of sukuk Market in Malaysia

According to ([Islamic & Insights, n.d.](#)), retail Sukuk which seeks to make Sukuk accessible to individual investors and increase retail participation in the market considered to be the recent market developments pertains to the introduction of In September 2012. Furthermore, Sustainable and Responsible Investment (SRI) Sukuk the first SRI Sukuk issued for the purpose of financing education was by Khazana Nasional Berhad in June 2015 under the SC's SRI Sukuk Framework (2014). The purpose for this initiative is to accomplish the UN Sustainable Development Goals (SDGs) which seek to transform the world by targeting several socio-economic development issues by 2030.

Legal And Regulatory Challenges of Malaysian Sukuk Market

Malaysia however is the world leading hub for Islamic capital market specially in term of sukuk and have the pride of comprehensive regulations, and tremendous amount innovation in sukuk market specially in socially responsible investment sukuk while this country Islamic capital market has been still facing some challenges. Regulatory framework is still at not yet fully developed in order to convince all its the sukuk holders around the globe. Malaysia however is the biggest issuer of sukuk, while there has been still a clash of regulations of Malaysian Islamic capital market with the other markets in GCC. Furthermore, Malaysian sukuk market with own regulatory bodies need to have a harmonized global regulation for its development and impacts. Today in all over the globe there are distinguished regulatory bodies for the sukuk markets. Hence, lack of unit and a coordinated regulatory body will directly create its impacts on Malaysian sukuk market and will exist uncertainty among sukuk holders around the globe.

Legal Challenges of Sukuk from Other Market Perspectives

The legal challenges facing sukuk issuance and governance extend beyond Malaysia and the UAE, as various jurisdictions encounter unique regulatory and legal constraints. In Indonesia, the legal foundation for sukuk development is considered inadequate. This is primarily due to the fact that the broader framework for Islamic financial institutions continues to rely heavily on conventional banking laws and regulations, which do not fully accommodate the specific characteristics and principles of Shariah-compliant instruments ([Nazar, n.d.](#)). This legal overlap creates uncertainty and limits the operational flexibility of Islamic finance products, including sukuk.

From the perspective of the United Kingdom, sukuk face a different set of legal complications. Under the Financial Services and Markets Act 2000 (FSMA), sukuk instruments may fall within the definition of a Collective Investment Scheme (CIS). If treated as such, sukuk issuers would be subject to more stringent regulatory requirements, including asset eligibility constraints, gearing limits, and marketing restrictions. This regulatory classification places sukuk at a potential disadvantage relative to conventional debt securities, thereby hindering their growth in Western markets. Moreover, a broader legal concern relates to the enforceability of sukuk contracts in jurisdictions where Western legal systems conflict with Shariah principles. Disputes arising from differing interpretations between civil law and Islamic jurisprudence continue to pose significant obstacles to the global standardization and acceptance of sukuk.

Sukuk Default Mechanisms and Challenges in Malaysia

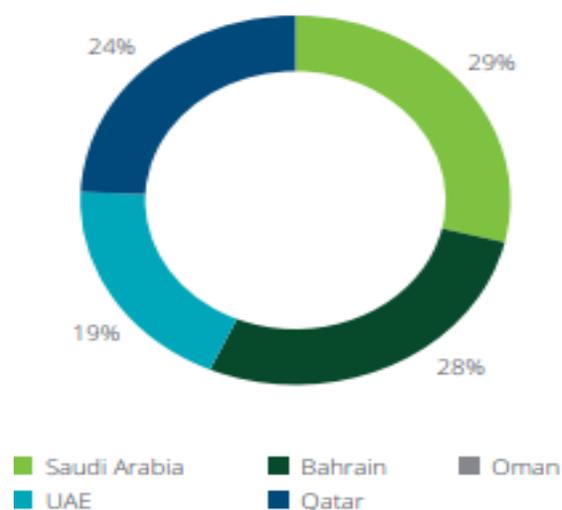
In the context of Islamic finance, a sukuk default—referred to in Arabic as *takhallafa 'an sadad*—denotes a failure to fulfill financial obligations, whether stemming from the anticipated profit pool or the underlying asset supporting the sukuk structure (Deloitte & ISRA, 2018). Etymologically, the Arabic term *takhallafa* originates from the root letters *kha*, *la*, and *fa*, meaning "delay" or "to come after," and is often used to describe an inability to meet contractual promises or financial terms (Busari & Zakariyah, 2019). In Malaysia, sukuk defaults generally occur when the issuer's financial condition deteriorates to the point that cash flows are insufficient to meet payment obligations, casting serious doubt on the issuer's capacity to service the debt (Bixmalaysia, 2019). In such cases, several mechanisms are available to address defaults, including debt restructuring, cross-default clauses, judicial management, and winding-up procedures. These processes are grounded in Malaysia's regulatory framework, particularly under the Securities Industry (Amendment) Act No. 2 of 1988 (Act 1040), which grants the Securities Commission Malaysia oversight and regulatory authority over the capital markets, including sukuk issuance and governance.

Despite Malaysia's leadership in establishing a robust legal and regulatory infrastructure for sukuk, certain challenges persist—primarily related to investor education and awareness. One critical factor contributing to defaults is the lack of investor knowledge, especially among retail participants unfamiliar with the nuances of sukuk structures and their covenant frameworks. Inadequate understanding can lead to misinformed investment decisions and increased exposure to default risk. Additionally, the passive involvement of unsophisticated investors, often influenced by third-party recommendations rather than informed judgment, exacerbates the issue. The absence of comprehensive awareness campaigns by regulatory bodies such as the Securities Commission Malaysia and Amanah Raya Trustees further compounds this problem, underscoring the need for enhanced investor education and more proactive engagement from relevant authorities (Busari & Zakariyah, 2019).

United Arab Emarat Sukuk Market

According to (Deloitte and ISRA, 2018), UAE with 2.28 billion US\$ and 19% of sukuk issuance possession is the fourth sukuk market in Gulf corporation countries (GCC) countries. Based on (Market, 2020), The Government of Sharjah (GoS), the third-largest constituent of the United Arab Emirates, on 26th March 2019, acting through Sharjah Finance Department (SFD) successfully priced a 7-year USD 1 billion Reg S only Sukuk off its Trust Certificate Issuance Programme. In term of sukuk types in UAE sukuk market Sukuk al-Ijarh, Sukuk Mudaraba, Sukuk Murabaha, Sukuk Musharakah Are the main types in that market.

Figure 2. United Arab Emarat Sukuk Market



Legal And Regulatory Framework of UAE Sukuk

United Arab Emarat have officially published new standards to monitor and oversee sukuk investment in Dubai. This is a commendable achievement, owing to the regulatory difficulties in the UAE's Islamic finance sector. The new UAE sukuk standard contains capital market regulations that address the issues that may arise when issuing, purchasing, and trading sukuk (Ercanbrack, 2020). Many of the laws governing Islamic financial services are scattered through several pieces of legislation, and the coverage of issues (such as consumer protection) is broad rather than detailed. Other than that, in the Dubai International Financial Centre, the main governmental and regulatory policies that control the UAE banking sector, including Islamic banks (DIFC). the regulatory framework is the Dubai Financial Services Authority), are UAE Federal Law No. 14 concerning the Central Bank and Organization of Financial Institutions and Banking, which took effect on September 30, 2018, and abolished UAE Federal Law No. 10 of 1980 concerning the UAE Central Bank, and the Banking Law, which came into force on September 30, 2018.

Recent Development of Sukuk Market In UAE

According to (Education, 2020), Green and SRI (socially responsible investment) sukuk grew in prominence in the United Arab Emarat. Other than that, regulations and policies response by publishing of new standards, rules and fatwas for sukuk issuance after 2017 sukuk defaults of Dana gas is another main development in term of legal perspective in the sukuk market of UAE (Market, 2020).

Legal and Regulatory Challenges of UAE Sukuk Market

legal Sukuk progress varies across Islamic finance countries, but it is a major determinant of sukuk success (Mrad, 2014). The legal basis for sukuk development in the United Arab Emirates is insufficient since the legal basis for Islamic financial development as a whole still relies on traditional banking laws and regulations. This part of the study illustrates the legal and regulatory challenges in the United Arab Emarat Sukuk Market.

1. Absence of Standard Legal Rules

in Untied Arab Emirate sukuk market lacks standard legal rule. This is a major obstacle to further development of sukuk market in that country (Ercanbrack, 2020). The lack of standardization of documentation and interpretations across jurisdictions makes UAE's secondary market of sukuk sluggish and dull because structures that are deemed acceptable in one market may not be equally accepted in another jurisdiction. In the result some issuers favor the conventional route rather than launch sukuk.

In order to illustrate this challenge further this study addressed the Sukuk default case of Dana gas company. Dana gas company has Established in December 2005, Dana Gas is the Middle East's first and largest regional private sector natural gas company. The company is publicly listed on the Abu Dhabi Securities Exchange (ADX) and, as at June 11, 2017, had an issued and fully paid-up share capital of approximately 6.98 billion shares of AED 1 (USD 0.2728) each and a share price of AED 0.60. In 2017 unilaterally declared that its US\$700 million worth of Mudaraba sukuk (the Sukuk), which is still outstanding, was no longer Shari's compliant and therefore, unlawful under the laws of United Arab Emirates (UAE). Following the declaration, Dana Gas claimed that this situation has made the sukuk unlawful in the UAE and therefore the company will not be fulfilling its payment obligation under the sukuk and will instead seek a restructuring of the instrument. The decision was contested by the sukuk holders, who appealed against the company in the court of United Kingdom. On the other hand, Dana Gas opted for Sharjah court to proceed with litigation. This situation is the result of the fact that the sukuk document is governed by the U A E laws but the 'Purchase Undertaking' which was part of this contract is governed by English law. Dana Gas went on to pursue separate rulings, from the Sharjah Federal Court of First Instance and the English High Court (Investment, 2020).

2. Stringent to Maturity

This is another legal challenge for the UAE sukuk market that its sukuk holders prefer to buy the sukuk and hold it until maturity rather than trade (Hanefah & Sains, n.d.). These sukuk holders keep their sukuk rather than selling because of the difficulty of finding more sukuk.

3. High Cost

Despite huge amount of sukuk issuance in recent years, it is not sufficient yet due to challenge in sukuk issuance, sukuk issuers shy away from issuing sukuk. First of the challenges is high issuance costs. As a result, this exists shortage of sukuk supply in the market.

4. Inaudible Default Mechanisms for Transactions

A significant legal issue in term of sukuk issuing in the Sukuk market of UAE is the inaudible clearness in post default of the contracts. In this existence of this uncertainty owners of Fixed income tend to shy away from instruments with limited visibility on post-default resolution.

5. Role of Rating Agency

Rating agencies' sukuk rating methodology is close to that of traditional bond ratings, and no independent sukuk rating agency has yet to be established.

Sukuk Defaults mechanism of UAE Sukuk market

Hesitations in legal systems, Shariah interpretations, investor rights, and solutions in default situations continue to be problems for the emerging Islamic finance industry. One of the major problems facing the Islamic capital market is the occurrence of Sukuk default. Sukuk investment laws and supervision in the UAE are focused in part on common law and in part on Shariah law. New standards for governing and supervising Sukuk investments in Dubai have been officially published by the UAE. This is a commendable effort, particularly given the challenges that the UAE's Islamic finance market faces. These guidelines provide oversight and clarity for issues arising from the issuance, acquisition, and trading of Sukuk.

This enhancement aims to fix, among other things, the problem of Sukuk default, which often jeopardizes the investor's rights and interests. The Dubai Financial Market standard no. 2 on the security of Sukuk investors' rights states that Sukuk holders of any issuance can form an association with the common goal of safeguarding their members' Sukuk investment rights. The association will retain legal representation for the duration of the Sukuk investment's contractual term, after which it will be dismissed by the Dubai Financial Market prospectus no. 13. The association is legally recognized in order to protect the interests of its stakeholders in the Issuances transaction through taking effective legal steps such as insolvency via insolvency (Busari, Zakariyah, & Abdul Aziz, 2019).

CONCLUSION

The Islamic capital market has grown significantly since its inception, especially due to its stability after the 2008 financial crisis. Sukuk, valued at around \$115 billion, is one of its key instruments. Malaysia leads the global sukuk market, supported by strong legal and regulatory frameworks, and is a major contributor to the growth of socially responsible sukuk. In the UAE, recent developments include the rise of green sukuk and related policy initiatives.

Despite these positive trends, challenges remain—especially in the UAE. These include the lack of standardized legal frameworks, limited awareness among sukuk holders, unclear dispute and default resolution mechanisms, and the absence of independent rating agencies. To support sukuk market growth, this study recommends a collaborative effort among institutions like AAOIFI, IFSB, and IIFM to develop unified and inclusive standards for Sharia compliance and legal documentation. Ideally, the sukuk issuance process should be as efficient and transparent as that of conventional bonds. Standardized Sharia guidelines are crucial to reduce legal uncertainty and help investors better understand the risks involved.

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